No. 90-373

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KPMG PEAT MARWICK,

Petitioner,

—v.—

W. DAVID HOLLOWAY, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF IN FURTHER SUPPORT OF PETITION

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Reference is made to Peat Marwick's statement pursuant to Rule 29.1 at page iii of the Petition for a Writ of Certiorari ("Pet.").

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REPLY BRIEF IN FURTHER SUPPORT OF PETITION

This reply brief responds to the principal new arguments advanced by respondents in the brief in opposition ("Br. Op.").

I.

THE TENTH CIRCUIT'S HOLDING THAT STATE REGULATION IS WHOLLY IRRELEVANT TO DETERMINING THE APPLICABILITY OF THE FEDERAL SECURITIES LAWS TO THE INSTRUMENTS AT ISSUE IS RECOGNIZED TO BE IN CONFLICT WITH THE DECISIONS OF OTHER CIRCUIT COURTS AND WARRANTS REVIEW

Respondents concede that (i) at least one opinion of a federal court of appeals (the Fourth Circuit) is in "direct conflict" with the holding below that no amount of state regulation is sufficient to satisfy the *Marine Bank* v. *Weaver* (455 U.S. 551 (1982)) standard (Br. Op. at 9, 14);[1] (ii) the decision of the Tenth Circuit below is also in conflict on this point with the "reasoning" of decisions in other circuits (the Fifth and the Ninth Circuits) as well (Br. Op. at 15, n.19) and (iii) this Court's opinion in *Reves* v. *Ernst & Young* (110 S. Ct. 945 (1990)) does not compel the holding arrived at by the Tenth Circuit with respect to this issue (Br. Op. at 16). In light of this series of concessions, respondents' halfhearted suggestion that the acknowledged conflict among the circuits does not warrant resolution at this time by this Court is untenable.[2]

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1 Respondents acknowledge (as did the Tenth Circuit) the direct conflict between the decision below and *Tafflin* v. *Levitt*, 865 F.2d 595 (4th Cir. 1989), *aff'd on unrelated issue*, 110 S.Ct. 792 (1990). In *Tafflin*, the Fourth Circuit held that notwithstanding the absence of federal regulation or federal deposit insurance the existence of a state regulatory system precluded treatment of the certificates of deposit before it as securities.

Respondents cannot bring themselves to defend fully the Tenth Circuit's holding as to the wholesale irrelevance of state regulation and suggest, without any explanation, that the holding was not necessary to the decision. *See, e.g.*, Br. Op. at 16-19, and especially n.22. Given the substantial state regulation applicable here and described in the Petition at 6-8, the holding as to the irrelevance of state regulation was plainly necessary to the result reached below.

2 Respondents acknowledge that the Tenth Circuit's reading of *Reves* revises *Marine Bank* in that the previously independently dispositive *Marine*

Respondents argue, in the alternative, that the holding was correct given this Court's decision in *SEC* v. *Variable Annuity Life Insurance Co. of America*, 359 U.S. 65 (1959), since, they contend, that decision made clear that even extensive state regulation did not mean that "the federal securities laws do not apply" (Br. Op. at 18). But that case, dealing with explicit exemptions in the securities laws (and analogous provisions in the McCarran-Ferguson Act, 15 U.S.C. §§ 1011 *et seq.* (1988)) for contracts of "insurance", turned on the meaning of that phrase in the federal statutes. Indeed, the Court emphasized its "reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or superimposing federal requirements on transactions that are tailored to meet state requirements." 359 U.S. at 68. It was the Court's conclusion that the variable annuity contracts were not insurance contracts at all that provided the basis for decision. 359 U.S. at 70-73. This rationale hardly provides a basis for reading into the subsequently decided *Marine Bank* and *Reves* a "federal regulation only" limitation that even respondents implicitly recognize cannot be found in the Court's holdings (*see* Br. Op. at 17).

Apart from the fact that state regulation or state and federal regulation combined may lead to the conclusion that an instrument is not a security under the *Marine Bank* approach, it also appears that Congress plainly intended to exclude depository instruments from its definition of securities. This

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Bank standard is now "to be considered as one of the four [*Reves*] factors, not as a separate consideration which might remove the instrument from the protection of the federal securities law even if it otherwise qualified as a security." Br. Op. at 16. Respondents resist the obvious implication of this reading (Br. Op. at 19). Under such a reading, however, the issue of whether a given bank certificate of deposit is a security, seemingly resolved by *Marine Bank*, would no longer be considered definitively resolved, but instead would be subject to the four factor analysis announced in *Reves* but never undertaken in *Marine Bank*.

The unsettling of what was thought previously resolved law only emphasizes the need for review of the basic issue of the role of regulation generally, and state regulation in particular, in determining whether instruments issued by financial institutions are securities.

intent is demonstrated in the plain language of the Securities Acts' definitions and is inherent in the distinctions set forth in the Glass-Steagall Act. As discussed in the Petition at 21-25 and at Point II, *infra*, this basic definitional question is one appropriate for resolution by this Court as well. The Congressional intent to exclude depository instruments and the distinct statutory framework applicable here, of course, also supply a wholly separate reason that *SEC* v. *Variable Annuity* provides no support for the decision below.

II.

THE DECISION BELOW DEPARTS FROM THIS COURT'S DECISIONS IN THAT IT FAILED TO CONSIDER THAT NEITHER THE LANGUAGE OF THE SECURITIES ACTS' DEFINITIONS NOR THEIR LEGISLATIVE HISTORY SUPPORTS TREATING CERTIFICATES OF DEPOSIT OR PASSBOOK ACCOUNTS AS SECURITIES

The Petition presents the question of whether, in failing to include certificates of deposit, passbook accounts or similar instruments in the Securities Acts' definitional sections despite its familiarity with these terms, Congress intended to exclude such instruments from the coverage of the Acts. Respondents do not appear to contest that certificates of deposit and passbook accounts as such are excluded. Instead, even as they list, by name, examples of the instruments at issue here, including "Market Rate Savings Thrift Certificate," "Money Market Thrift Certificate" and "Passbook Savings Certificate" (Br. Op. at 3), all of which are strikingly similar to the excluded instruments, respondents appear to contend that Congress intended to regulate *these* instruments as securities. The label annexed to an instrument is not, of course, dispositive, *cf. Marine Bank*, *supra*, 455 U.S. at 560 n.11, but it would appear as an initial matter that the instruments at issue here, in their similarity to certificates of deposit, passbook accounts and other depository instruments,

are precisely the kinds of instruments Congress did not intend the Securities Acts to reach.

The Securities Acts, of course, do not define "certificate of deposit" or "passbook" accounts or the range of other similar instruments Congress did not intend to include in the definition of securities. A number of other authorities are helpful in divining Congressional intent in this matter, however. Among the most helpful is the Glass-Steagall Act, in which the very Congress that enacted the Securities Acts identified and described a variety of depository instruments plainly absent from the Securities Acts' definitional sections. The instruments at issue here, as discussed below and in the Petition at 5-6, 22-24, fall squarely within the Glass-Steagall description of depository instruments.[3]

Respondents, while acknowledging that the instruments at issue here are considered deposits in some contexts, Br. Op. at 20, n.24; *see also* Pet. at 5-6, turn to other, non-contemporaneous and non-analogous authorities to support their position that the instruments were not "deposits" and, they contend, therefore to be treated as ordinary debt instruments or notes rather than the special type of debt or note represented by certificates of deposit and the like. Respondents rely primarily on a line of cases interpreting the Bankruptcy Code's definitional requirements. Br. Op. at 11, 20. But to find similar instruments not to be "deposits" for the special purposes served by the Bankruptcy Code hardly leads to the conclusion that the instruments are not deposits or deposit-like for other purposes as the district court recognized in this case in likening these instruments to deposits (App. 44a, 47a). Nor does it avail respondents to argue that the institutions here are not "banks." As Glass-Steagall

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3 Respondents' summary of Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378 (1988), a section which reflects the understanding of the Congress that enacted the Securities Acts, is a poor substitute for the statutory text (set forth at Appendix ("App.") to Petition at 87a-88a). Br. Op. at 21. For instance, Section 21 speaks not of "demand deposits," as respondents would have it, but of precisely what is at issue here—"deposits subject to check or repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor". 12 U.S.C. § 378(a).

itself reflects, Congress contemplated that many institutions would perform bank-like functions and recognized the clear distinction between such activities and the issuance of securities.

The balance of the citations offered by respondents for the proposition that the instruments are not deposits (and, as they reason, therefore *are* securities) are off the point and fail, in any event, to address the more fundamental question of whether Congress intended these instruments to be included within the definitions when it apparently intended certificates of deposit to be excluded. Thus, notwithstanding respondents' contrary suggestion (Br. Op. at 11), the Oklahoma Banking Code affirmatively empowers trust companies to accept a variety of deposits. Okla. Stat. Ann. tit. 6, § 1001(A)(1) (West 1984). Respondents cite an opinion of the Attorney General of Oklahoma which recognized the State Banking Commissioner's powers to include supervision of securities issued by trust companies (Br. Op. at 3, 20) to suggest that the instruments at issue here are therefore securities. But in the opinion in question, the Attorney General of Oklahoma opined that the Oklahoma Banking Department "has supervisory responsibility with respect to *banks and* trust companies issuing securities". No. 79-353, 11 Op. Att'y Gen. Okla. 574 (Dec. 31, 1979) (emphasis added). The opinion in no way suggests that the instruments in question are "securities" if issued by a trust company, but "deposits" if issued by a bank.

Significantly, respondents fail to address the fact that respondents' counsel themselves, presumably aware of the various materials they now cite, formed the view that the instruments at issue were "deposits" and that the plaintiffs were "depositors" and used these terms in the complaint in this very action. Amended Complaint ¶¶ 3.1, 3.2, 4.1. This itself suggests the appropriateness of treating the instruments as posing the same issues under the securities laws as do other instruments commonly regarded as deposits.[4]

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4 Respondents' brief itself serves to emphasize the real distinctions between the regulation of depository instruments issued by banks and similar

III.

THE QUESTION LEFT OPEN IN *REVES*, OF THE APPLICABILITY OF THE 1934 ACT EXCEPTION FOR NOTES WITH MATURITIES OF NINE MONTHS OR LESS, IS PRESENTED BY THIS CASE AND IS RIPE FOR REVIEW

Respondents do not contest that this case squarely presents the issue of whether notes with maturities not exceeding nine months are securities for the purposes of the Securities Exchange Act. Instead, respondents state (without record citation or elaboration) that this issue "was not fully briefed and argued below and the Tenth Circuit did not fully consider it." Br. Op. at 10, 22, 23. This argument is entirely and demonstrably wrong.

The question of the applicability of the nine-month exception was considered and ruled on by the Tenth Circuit in its first decision. 879 F.2d at 778; App. 20a ("the literal language of the 1934 Act . . . cannot be read literally to include or to exempt 'any note' based on maturity alone"). *See also* Brief of Plaintiffs-Appellants dated July 13, 1987 at 37, n.12 (respondents themselves argued below that notes are to be "subjected to the securities laws without regard to . . . maturity"). Peat Marwick addressed this issue in its first Petition for a Writ of Certiorari in this action (No. 89-532), dated September 29, 1989 (pp. 27-28). This Court granted the petition, vacated the judgment below and remanded the case for further consideration in light of *Reves* v. *Ernst & Young*, 110 S. Ct. 945 (1990), a case in which the plurality expressly

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financial institutions and regulation under a securities regime. Thus it emphasizes the series of cease and desist orders issued by the Federal Reserve Board in the course of its oversight in this matter (while simultaneously denigrating the significance of federal regulation). Br. Op. at 8-9, 11-12. Significantly, these orders were, when issued, confidential as a matter of Federal Reserve policy. Such emphasis on confidentiality, a hallmark of bank-type regulation, is flatly inconsistent with the disclosure goals of securities law. The Tenth Circuit's first decision recognized the differences between these policy goals (879 F.2d at 786; App. 34a) but ignored them in its holding.

declined to reach the question of the nine-month exception; five other members of the Court, however, addressed the issue.[5]

On remand, the Tenth Circuit again *ruled* on this issue in its supplemental opinion: "the section 78c(a)(10) exception for short-term notes is limited to prime quality negotiable commercial paper of a type not ordinarily purchased by the general public" and therefore "section 78c(a)(10) does not exclude [the instruments at issue] from the federal securities laws"[6] (900 F.2d at 1489; App. 7a-8a). (Respondents concede that this ruling constitutes a "holding" of the Tenth Circuit (Br. Op. at 23).) Peat Marwick timely filed a Petition for Rehearing, with Suggestion for Rehearing En Banc, explicitly addressing the nine-month exception, its treatment in the *Reves* opinions and its applicability to this case (pp. 12-15).[7] The Tenth Circuit thereafter denied rehearing. It is plain that the issue was directly resolved by the court below and was preserved for review by this Court.

To the extent respondents address the merits of the vexing substantive issue of the proper interpretation of the nine-month exception, their arguments only underscore the need for final resolution of an issue that at least five members of this Court were prepared to decide in *Reves*. Indeed, commentators have made just that point. *See* Note, *Notes Under*

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5 Justice Stevens, concurring, concluded that the notes in question were securities notwithstanding the nine-month exception. 110 S. Ct. at 955-56. Chief Justice Rehnquist, joined by three other Justices, concluded that "there is no justification for looking beyond the plain terms" of the exception. 110 S. Ct. at 960 (Rehnquist, C.J., concurring in part and dissenting in part).

6 In twice explicitly ruling on the subject the Tenth Circuit preserved the issue for review even had Peat Marwick not, as set forth in the text, explicitly briefed the issue. *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976) (per curiam).

7 The Tenth Circuit did not authorize post-remand briefing prior to the issuance of its supplemental opinion. The argument in question would have been properly preserved for review even had it appeared *only* in the Petition for Rehearing and had *not* been ruled on by the court below. *Bankers Life & Casualty Co.* v. *Crenshaw*, 486 U.S. 71, 77 (1988); *Hathorn* v. *Lovorn*, 457 U.S. 255, 262-65 (1982).

the Securities Exchange Act of 1934: An Argument for a Plain Reading of the Nine Month Exception, 1990 Colum. Bus. L. Rev. 163.

Respondents suggest that it is premature to resolve the question as to the meaning of the nine month exception identified but not resolved by this Court in *Reves*. A majority of the members of this Court have already expressed a view on this issue, an issue which has also been considered by most of the courts of appeals. The issue requires no further incubation and this case presents the proper vehicle for its resolution.

* * *

Respondents' own description of the instruments at issue suggests the variety of such instruments in terms of lengths of maturity (ranging from notes of an essentially demand character to instruments with three-month, six-month and longer maturities) and the distinct types of regulatory oversight exercised with respect to the different instruments. This Petition thus presents a suitable vehicle to resolve a number of questions concerning the definition of securities in a range of factual contexts. The resolution of these questions would be of substantial assistance to the financial community, regulators and the public.

CONCLUSION

For the foregoing reasons and the reasons set forth in the Petition, the petition for a writ of *certiorari* should be granted.

Dated: New York, New York
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